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No. 87-98

In the Supreme Court of the United States

OCTOBER TERM, 1987

BRUCE AND JOANNE BROWN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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Petitioners contend that the Tax Court erred in denying them a casualty loss on the ground that they were not the owners of certain flooded property.

1. The A Bar A Ranch comprised approximately 1,166 acres of land located in Bandera County, Texas. In 1978, E.M. Anderson, Jr., owned approximately 526 acres of the ranch; the remaining tract of 640 acres was owned by his mother's estate, of which Anderson was the executor. By letter dated June 19, 1978, petitioner[1] advised his attorney that he was planning to acquire these tracts—one for himself and the other for the PBJ Trust, which had petitioner as its trustee and his children as its beneficiaries. On June 30, 1978, the PBJ Trust purchased the 640-acre tract for $384,600. Pet. App. A2-A3.

[1] While Joanne Brown is a party to this litigation because she filed a joint federal income tax return with her husband for the 1978 taxable year, for convenience we will use the term "petitioner," referring to Bruce Brown, who was the principal actor in the transactions at issue.

By letter dated June 14, 1978, petitioner proposed to Anderson a lease with an option to purchase the 526-acre tract (Pet. App. A3). Petitioner tendered with this letter a check in the amount of $37,500 (*id.* at A6). By letter dated June 30, 1978, Anderson accepted the lease-option proposal, enclosing the signed agreement and a correct legal description of the property (*id.* at A7).[2] In July 1978, the Andersons moved out of the A Bar A Ranch, but their son Don continued to live in one of the houses, paying petitioner rent in the amount of $150 per month. One of petitioner's employees also lived at the ranch during 1978. *Ibid.*

In August 1978, the Medina River overflowed its banks and damaged the 526-acre tract. On November 14, 1978, the Small Business Administration approved a loan to petitioner, in the amount of $147,800, to be used to repair the damage to the ranch. Pet. App. A7-A8.

Petitioner never exercised the option as set forth in the original agreement. In November 1978, petitioner prepared a draft of an option agreement to supersede the

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[2] Under the terms of the lease agreement, petitioner was to pay $10,000 per year as rent for two years, $5,000 payable immediately and $5,000 semiannually thereafter. The lease obligated petitioner to maintain insurance on all buildings. Under the option portion of the agreement, petitioner was to pay $65,000 to preserve the option, $32,500 down and $32,500 on or before December 30, 1978. Failure to exercise the option or to make the second payment would result in the loss of the option and of the down payment. If petitioner chose to exercise the option, he was required to give 60 days' notice by certified or registered mail and, if he had not yet made the second option payment, to deposit $32,500 in escrow as earnest money. All monies paid for the option and/or earnest money would be credited toward the purchase price. Upon receipt of petitioner's notification of intent to exercise the option, Anderson was required to deliver a warranty deed within 60 days. Petitioner, in turn, was required at closing to deliver the balance of the down payment ($85,000), and a promissory note in the amount of $600,000. Taking into account the credit for the $65,000 option price, this amounted to a total purchase price of $750,000. Pet. App. A3-A6.

lease-option agreement accepted by Anderson on June 30, 1978. This superseding agreement was considered by Anderson, but was never executed. On December 26, 1978, petitioner and Anderson agreed upon substantial modifications in the terms of the lease-option agreement.[3] Petitioner then delivered a check in the amount of $77,500 to Anderson and $67,500 of that amount was credited toward the down payment. Pet. App. A8-A9.

The closing of the sale of the 526-acre tract occurred on February 6, 1979. The closing statement contained a notation that the "[e]ffective date of deed is July 1st, 1978, the date when Purchasers gave verbal notice to Sellers that Purchasers exercised earlier option to purchase, with certain changes." Although the deed was executed by the Andersons on February 6, 1979, it was backdated so as to appear that it had been signed on July 1, 1978. Petitioner thereafter signed a promissory note, dated July 1, 1978, which reflected the terms of the December 26, 1978, modifications. Petitioner then insured the property, effective March 1, 1979; Anderson's policy had insured the property until June 21, 1979. Pet. App. A10-A11.

2. On his federal income tax return for 1978, petitioner claimed a casualty loss deduction of $364,900, pursuant to Section 165 of the Internal Revenue Code (26 U.S.C.), with respect to the flood damage to both tracts of the ranch (Pet. App. A12).[4] Petitioner's return was

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[3] The modifications were as follows: (1) the down payment was reduced from $150,000 to $100,000; (2) the time for repayment was extended from 10 years to 15 years; (3) the requirement that earnest money be deposited in escrow upon exercise of the option was eliminated; (4) interest on the note would not begin to accrue until July 1, 1979; (5) the first payment would consist only of six months of interest and would not be due until January 1, 1980; and (6) the first of the 30 semiannual installments of principal plus interest would not be due until July 1, 1980 (see Pet. App. A9).

[4] Petitioner obtained an appraisal estimating both curable and incurable damage to the 526-acre tract at $348,000, and damage to the

selected for audit. During the course of the examination, petitioner, on several occasions, denied having ever leased the 526-acre tract. Later, petitioner represented that certain documents executed in 1979 had been executed in July 1978. *Id.* at A16-A18.

The Internal Revenue Service issued a notice of deficiency which, inter alia, disallowed the claimed casualty loss deduction on the ground that petitioner had failed to show that he owned or had legal title to the acreage on or before the date of the flood or that any loss was incurred during 1978 (Pet. App. A12). The Commissioner also imposed an addition to tax for fraud pursuant to Section 6653(b) of the Internal Revenue Code (26 U.S.C.) (Pet. App. A41). Petitioner filed a petition for redetermination of his tax deficiencies in the Tax Court.

3. The Tax Court sustained the Commissioner's notice of deficiency (Pet. App. A1-A43). Noting that "the demeanor and [the court's] view of the credibility of the witnesses, including petitioner, * * * played an important part" in its determination (*id.* at A21), the court held that petitioner was not entitled to a casualty loss deduction for the flood damage (*id.* at A21-A33). The court explained that petitioner had the burden of proving his entitlement to the deduction and that the evidence satisfied the court that petitioner had neither legal nor equitable title to the property before the date of the flood. The court specifically found that the original option was not exercised and that no binding contract of sale was entered into until December 26, 1978 (*id.* at A33). With respect to

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640-acre tract at $17,000. Pursuant to Section 165(c)(3), petitioner then subtracted the $100 statutory deductible and so reported a loss in the amount of $364,900 on Schedule A of his 1978 income tax return. Pet. App. A8, A12. Because the larger tract had been purchased by the PBJ trust, petitioner had no conceivable basis for claiming a deduction as to damage to that property (see *id.* at A23).

petitioner's contention that his possession of the property before the flood was an indication of beneficial ownership, the court noted that this fact was "of no consequence" since the lessee status conferred upon petitioner by the original lease-option agreement entitled him to possession (*ibid.*). The Tax Court also sustained the Commissioner's determination that petitioner was liable for a fraud penalty, noting petitioner's denial that he ever leased the property and the deliberate backdating of documents (*id.* at A41-A43). The court of appeals affirmed in an unreported order (*id.* at A45).

4. Petitioner contends that the Court should grant certiorari here because the Tax Court applied a legal standard in determining the ownership question that is "in direct conflict with the benefits and burdens test applied by the Fifth, Ninth, Tenth and Eleventh Circuits" (Pet. 6). This contention is wholly without merit.

First, we note that one of the cases prominently cited by petitioner as setting forth the correct standard is *Boykin* v. *Commissioner*, 344 F.2d 889 (5th Cir. 1965) (see Pet. 6-7). Both *Boykin* and the instant case, in which the court of appeals did not issue an opinion, arose in the Fifth Circuit. Thus, with respect to that circuit, petitioner's suggestion that the decision below can be said to create a conflict in the circuits is patently erroneous.[5]

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[5] Petitioner asserts (Pet. 10) that the "formulations of the tests used by the various circuits to determine tax ownership are conflicting." The basis for this claim appears to be the fact that a Sixth Circuit decision, *Commissioner* v. *Segall*, 114 F.2d 706 (1940), cert. denied, 313 U.S. 562 (1941), uses the phrase "various factors," rather than "benefits and burdens of ownership" (see Pet. 8-9). But the most petitioner can show is that the courts of appeals have not been entirely uniform in their articulation of the test; there is no basis for asserting that the various circuits disagree in any material respect on the legal standard for determining ownership. All agree that the question of ownership depends on the particular circumstances of each case and that the passage of legal title is not necessarily determinative. Indeed,

In any event, there is no basis for asserting that the Tax Court decision affirmed by the court of appeals failed to apply the "benefits and burdens" analysis. It is true, of course, that the court devoted most of its discussion to its finding that legal title did not pass to petitioner until after the flood. But this was in response to petitioner's contention, based on backdated documents that the Tax Court held to be part of a fraudulent plan, that legal title did pass prior to the flood. The Tax Court, however, also rejected petitioner's claim that he had beneficial ownership or "equitable title", noting that the fact that he had taken possession of the property was irrelevant because he was entitled to possession as a result of his leasehold interest—*i.e.*, possession did not in any way indicate ownership. Pet. App. A33

Indeed, petitioner's own actions belie the conclusion that he had beneficial ownership of the property before the flood. Petitioner engaged in several fraudulent acts—backdating documents (Pet. App. A32, A43), representing that the documents had been signed on the earlier date (*id.* at A28, A43), and denying that he had leased the property (*id.* at A28, A30)—in order to attempt to establish that he held legal title at the time of the flood. As the Tax Court found, this deceptive conduct "was intended to support [petitioner's] claim to a casualty loss because of the flood at the ranch at a time when he was not the owner, *and he knew it*" (*id.* at A43 (emphasis in original)).[6] Thus, the question on which petitioner seeks review—the standard to be applied to ownership determinations—could make no difference to the result in this case.

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as petitioner acknowledges (Pet. 8), a later Sixth Circuit case specifically used the phrase "benefits and burdens of ownership" (*Dettmers* v. *Commissioner*, 430 F.2d 1019, 1023 (1970)).

[6] Petitioner asserts here (Pet. 10-11) that his beneficial ownership of the property is demonstrated by the fact that the sale was ultimately consummated for the same $750,000 price set forth in the original

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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option agreement, despite the intervening flood damage. But this fact is not very probative since failure to maintain the same sale price would have completely undermined the assertion that petitioner was the actual owner of the property at the time of the flood—an assertion that petitioner was attempting to support by engaging in several fraudulent acts. The fact remains that the terms of the actual sale were more favorable to petitioner than the terms of the original option (see note 3, *supra*). Moreover, if the property that petitioner eventually purchased was somewhat devalued by the flood damage, that devaluation was offset by petitioner's belief that the purchase, structured as it was, would enable him to take a $364,900 casualty loss deduction.

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